USDA REMARKS

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Agriculture Chief Economist Keith Collins
OUTLOOK FOR AGRICULTURE
Agricultural Outlook Forum 2003
February 20, 2003

"Good morning welcome to USDA's annual outlook forum. I am going to start things off by providing a brief overview of the outlook for agriculture, with a focus on production agriculture. As the next two days unfolds, this Forum will provide a much richer story about all the things going on from farm to consumer. For my part, I am going to make a few summary statements about developments in the world and U.S. agricultural markets and then provide a few details on each of these summary statements.

"My first summary statement starts with demand and it is this:
(1) I believe macroeconomic factors, such as the exchange value of the dollar and slow economic growth around the world, have constrained demand for U.S. agricultural products and farm prices and will continue to do so over the next year or more.

"The past 2 years have been disappointing as far as the U.S. economy goes. We have been continually pushing out into the future the expected rebound. Six months ago, the blue chip economists' forecast of U.S. GDP growth for 2003 was 3.5 percent. Now, it is 2.5 percent, the same rate as last year. The U.S. economy in 2003 will face some of the same restraints it faced in 2002: excess capacity, low returns in many sectors, high consumer and business debt, low consumer confidence, high unemployment, and weak growth in Japan and Europe.

"But on the positive side: interest rates are low; there is substantial liquidity in the economy; credit conditions appear to be easing; and fiscal policy is expansionary and may get more so with enactment of a growth package that cuts taxes or provides other stimulus; and unemployment is starting to decline. Unfortunately, though, we do not foresee stronger economic growth for the U.S., such as in the 3 to 3.5 percent range, until 2004.

"Figure 1 illustrates the annual percentage change in U.S. GDP plotted along with the annual percentage change in personal consumption spending on food. As you can see, when the U.S. economy is very weak, as in 1991 and in 2001, growth in food consumption slows. It did pick up in 2002, but was still not very strong, rising only 1.6 percent, which is half the rate of growth in 1999, when the economy was stronger and consumers were more confident. With the economy likely to move sideways this year, we can expect food spending to be similar to last year, perhaps slightly stronger.

"Figure 2 illustrates the generally stagnating pattern of consumer spending at grocery stores this past year. In fact, look at the dashed oval—it highlights grocery sales in the month of December which

shows they were the same as the previous December 2001

. This stagnation in spending was evident in food service sales as well.

"As the U.S. economy eventually starts growing faster, and it will, the farm economy will benefit from stronger domestic food sales. As we look to the future, we can expect American consumers to continue to shift their consumption patterns as factors like income, population diversity, age, and diet and health awareness drive change. A recent ERS study evaluated such factors and projected consumption patterns to 2020. I call your attention to the Forum session titled, "Forces Shaping America's Eating Habits" to learn more about this study. A general conclusion, illustrated in Figure 3, is that as the economy continues to grow and change, we can expect stronger per capita consumption for such foods as fruits, vegetables, yogurt, eggs, poultry, grains, and nuts, while milk, red meats and potatoes may face declines.

"But whether these commodities face bull or bear markets in the future will also depend on our ability to compete for markets abroad. As you can see in Figure 4, U.S. agricultural exports have fared reasonably well over the past couple of years given the slowdown of the world economy and the high value of the dollar.

"In 2003, the slow growth in global GDP, some help from the declining value of the dollar, and stronger farm prices, are expected to push U.S. agricultural exports to $57 billion, up from $53.3 billion in 2002.

"USDA released its long term baseline projections on February 7. They suggest some of the export pressures and opportunities U.S. farmers may face in the future. As shown in Figure 5, exports are seen rising to the old record of $60 billion by 2005 and then to nearly $72 billion by 2010. But the growth is all in intermediate and consumer ready products, not bulk, which are expected to face very strong competition. For many of the bulk products, their best entry into export growth markets will be in value-added and processed form, such as feed grains and protein meals exported as meat.

"M*y second summary statement relates to the supply side of markets and is this:*
(2) Weather remains the dominant factor shaping the near-term outlook. Drought in key areas in 2002, notably in Australia, Canada, and the U.S., depleted crop supplies in traditional exporting countries, and drought in Africa expanded global food aid needs. Weather raised many U.S. crop prices, and these higher prices are carrying into the first half of 2003. But, a rebound in yields and strong competition from both traditional and newer competitors, will likely cause a pull back in prices. The major uncertainty in this conclusion is the ongoing drought in the west.

"To illustrate this observation with a few details, I'll start with world grain production in 2002. The trend in world wheat and coarse grain production since the mid 1980s has been an annual increase of about 12-13 million tons, or 1 percent. But, in 2002, with bad weather in developed exporting countries, world production declined 40 million tons, or about 3 percent. Meanwhile, as shown in Figure 6, world grain use is pulling back only a little under the slowing world economy and the drop in grain production. With world production well below world consumption, carryover stocks at the end of this marketing year will fall. In Figure 7, you can see global grain stocks as a percentage of global use are expected to fall by the end of this marketing year to the same level as in 1995/96, when grain prices reached record highs.

"Global cotton and soybean stocks are also expected to decline this marketing season.

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"The upshot of these developments has been tighter global crop markets and higher U.S. farm prices for 2002/03. While prices have been higher than at any time since the mid 1990s, prices have been nowhere near the record levels reached then.

"One reason is large exports from a number of regions. Figure 8 simply adds the tons of grain and soybeans exported by China, the Former Soviet Union countries, India, Argentina and Brazil. To me, this figure is astonishing. These countries exported 30 million tons of grain and soybeans in 1994/95 and accounted for 13 percent of global grain and soybean exports. This marketing year, they will export over 100 million tons and account for 38 percent of global trade. Please note the distinguished speaker from Ukraine for tomorrow's grain and oilseed luncheon.

"The rise of these countries, and others waiting in the wings, such as in Eastern Europe, underlie our flat long-term projections for U.S. bulk commodity exports. These rising competitors, combined with a recovery in yields in places like Australia and Canada, suggest continuing pressure on profit margins for many U.S. producers of bulk commodities, unless new demand opportunities are found.

"With this tough global market in mind, let me say a few words about the U.S. prospects for the 2003/04 marketing year. With this year's wheat price very strong in the fall, winter wheat seedings were up 6 percent from last year and the highest since 1998. Since then prices have dropped and spring acreage is likely to be similar to a year ago. In total, wheat plantings are expected to be up about 2-1/2 million acres.

"USDA forecasts about a 1-1/2 million acre increase in corn area, with a similar drop for soybeans. Producers are expected to make these choices in response to relative prices and loan rates which favor corn and several years of disappointing soybean yields.

"Cotton planted acreage is likely to rise slightly this year, to 14 to 14.5 million acres, as prices are rising and exports look very strong as global production shrinks. With prices continuing weak, U.S. rice acreage may decline a little this spring.

"Combining these acreage changes with trend yields and our early guesses on demand, Figure 9 shows U.S. carryover stocks of wheat, corn, soybeans and cotton for the past 3 years and our forecast at the end of the 2003/04 marketing year. The data are presented as a percent of the 2000/01 carryover level. As you can see, all of these major crop markets are in better balance now than they were a couple of years ago. At this early point in the year, we expect 2003/04 U.S. wheat and soybean stocks to rise only slightly, even with wheat exports possibly falling below this year's expected 30-year low in exports. Corn stocks rise moderately as projected production exceeds 10 billion bushels and exports and domestic use increase slightly. And for cotton, we see even stronger exports than over the past two years, stable U.S. use and carryover stocks declining to the 5-million-bale range. These stock changes suggest season-average farm prices for wheat, corn and soybeans will likely decline from the 2002 crop year levels, but remain substantially above the 2001 levels. Cotton prices look to continue to strengthen.

"Turning to horticultural products, producers saw strong gains in sales in 2002 despite facing increased difficulties in international markets. U.S. fruits and vegetables sales totaled 6 percent above 2001. The increase was well above the trend increase of 2 to 3 percent, as both prices and production rose. Export growth has been slowing in recent years as global economic growth has slowed. Fresh citrus, processed products, wine, and nursery/greenhouse products suffered, while sales have been stronger in fresh vegetables and deciduous fruits, tree nuts, and juices.

"An important concern for all 2003 markets is the weather. Figure 10 shows the drought monitor as of February 11. It shows huge areas now in severe, extreme and exceptional drought. The next two figures show conditions for this time of the year in 2002 and 2001. Clearly, we start 2003 in a much more serious situation. With low stream flows, cooler weather and timely rains will be important for crop development in these western states.

"Turning to livestock, my third summary observation is this:
(3) Cattle, hogs and broilers, all down markets for farmers in 2002, are likely to reverse and be better performers in 2003. The exception in dairy where milk supplies continue to run high.

"Now for a few details. For 2003, lower beef and pork production and only a small increase in poultry production are expected to cause U.S. per capita meat consumption to fall about 2 percent and to boost meat, livestock and poultry prices and farm returns.

"Over the past two years we have been optimistic at this Forum about the coming year for ***cattle*** producers. It has not happened. Poor range and forage conditions and lack of feed caused a continuation of the liquidation of the U.S. cattle herd that began late in 1995. The nation's cattle inventory on January 1 was down for the 7th straight year. The question for 2003 is: will the bull return?

"Our cattle survey at the end of January 2003 indicated that producers expect 3 percent more heifers to calve this year. If this holds true, the cattle cycle should start to turn. However, turning the cattle cycle still depends heavily on weather developments this year. If drought conditions continue, producers may again send their heifers to feedlots instead of retaining them. Assuming adequate forage, beef production is forecast slightly lower during the first half of the year, but then to fall sharply in the second half and be down over 4 percent for the year. Choice steer prices are expected average in the mid-$70's per cwt during 2003, about 13 percent higher than last year. Consumers will face higher retail prices this year which could dampen beef demand somewhat, but beef exports are expected to expand, as shown in Figure 13.

"During 2002**,** hog prices were generally below breakeven, causing producers to trim back inventories and remain cautious. Hog inventories on January 1, 2003 were 1.5 percent lower than a year earlier. As a result, we expect pork production to decline slightly this year. With production pulling back, hog prices for 2003 are forecast at $38 per cwt, about 9 percent higher than in 2002, and slightly better than breakeven. Pork exports are also expected to increase.

"The poultry sector suffered considerable disruptions in export markets in 2002 as a result of avian influenza, Exotic Newcastle disease and Russia's cutback of imports. U.S. broiler exports in 2002 declined 12 percent, with shipments to Russia down about 30 percent.

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For 2003, broiler production is forecast to expand less than 1 percent, and production is expected to decline in the first and second quarters, the first two consecutive quarterly declines since 1975. Wholesale broiler prices are forecast at 60 cents per pound, 8 percent higher in 2003. Exports in 2003 are also forecast to rebound.

"Milk has the weakest prospects in the livestock product sector. With low prices a decline in milk cow numbers would be expected, but they have been above last year's levels. Continuing expansion in the west is one factor; another appears to be the Milk Income Loss Contract Program established in the 2002 Farm Bill, which may be influencing producer decisions to remain in business and to retain heifers. The all-milk price in 2003 is forecast at about $11.60 per cwt, the lowest milk price since 1978.

"Based on the prospects for markets I've just described, my final summary observation is this:

(4) The U.S. farm economy caught a cold in 2002, but it is not reeling as we enter 2003. Some producers, especially those affected by weather, do face serious problems. However, because of structural diversity and preventive steps, not everyone in agriculture is ill. Prospects for 2003 look stronger for many producers, but a boom is not in sight.

"Some details: in 2002, farm cash receipts for crops rose slightly, but livestock receipts fell $10.5 billion as prices fell sharply under the big, drought-driven increase in meat production and slower meat exports and lower milk prices. Another factor affecting farm income is the slow pace of farm program signup, which has resulted in $4 billion in government payments being shifted from the fall of 2002 into 2003. These factors combined to reduce farm income in 2002 quite sharply and cause it to drop below the levels we forecast a year ago. Net farm income, which includes noncash items such as depreciation and inventory change, fell 29 percent in 2002 from the 2001 level. Net cash farm income, which is gross cash income minus total cash expenses, fell 22 percent.

"So what does this income drop mean for the state of the farm economy? Consider net cash income, shown here in Figure 14. I like to use this as a summary measure because it is the income an operator has left over to pay living expenses, capital costs and service debt. In 2002, net cash farm income was as its lowest level since the mid 1980s. The big drop indicates many producers faced tight budget constraints in 2002, particularly those in weather-affected areas. Income declined occurred in all regions and was especially pronounced for hog and dairy operations. The drop in income has resulted in more loan extensions and lower rates of loan repayments. This continues to pressure input markets such as machinery sales. Many bankers tightened collateral requirements as their unease grew during 2002. At USDA, our farm loan delinquencies rose in 2002. On the other hand, farm interest rates continued to decline and banks remain in sound condition with loan to deposit ratios generally below desired levels.

"Several factors contribute to the economic resiliency of many farm households. First, three out of four farm households earn the majority of their income from off-the-farm sources. This reduces the impact of farm income changes–either up or down–on their well being. Second, the farms most dependent on farm income are the 10 percent of farms that produce two-thirds of the output, and these farms, on average, have household incomes that are well above the national average and remained so in 2002.

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Third, the value of farm assets continues to grow, giving some financially stressed producers a chance to weather a down period by selling some assets or borrowing against them.

"For 2003, net cash farm income is expected to rebound by 11 percent to over $51 billion, as both crop and livestock receipts grow and government payments rise. If government payments are excluded, net income from the market is expected to be little changed, as farm production expenses rise reflecting higher feed and feeder cattle costs and higher energy and fertilizer expenses. Figure 15 shows farmland values remain strong, rising an estimated 4 percent in 2002, but are expected to rise at a slower 1.5 percent in 2003, reflecting the reduced cash income in 2002 and flat market income expectations in 2003. For 2003, with slow growth in asset values but another boost in debt levels, the farm debt-to-asset ratio is forecast to move up to 16 percent a still healthy figure but the highest since 1998.

"As always, these observations about the farm economy must be weighed in light of a number of uncertainties. There are many: potential ***war*** and its impact on oil prices, investment, consumer spending and trade preferences by other countries; ***the global economy***, whether it moves outside the expected ranges and the behavior of exchange rates; ***foreign nations' farm and trade policies***, especially China for crop imports and exports, and places like Russia and Japan for meat imports; and finally, the ***weather*** –here as well as abroad.

"With that I thank you for your attention and enjoy the Forum."

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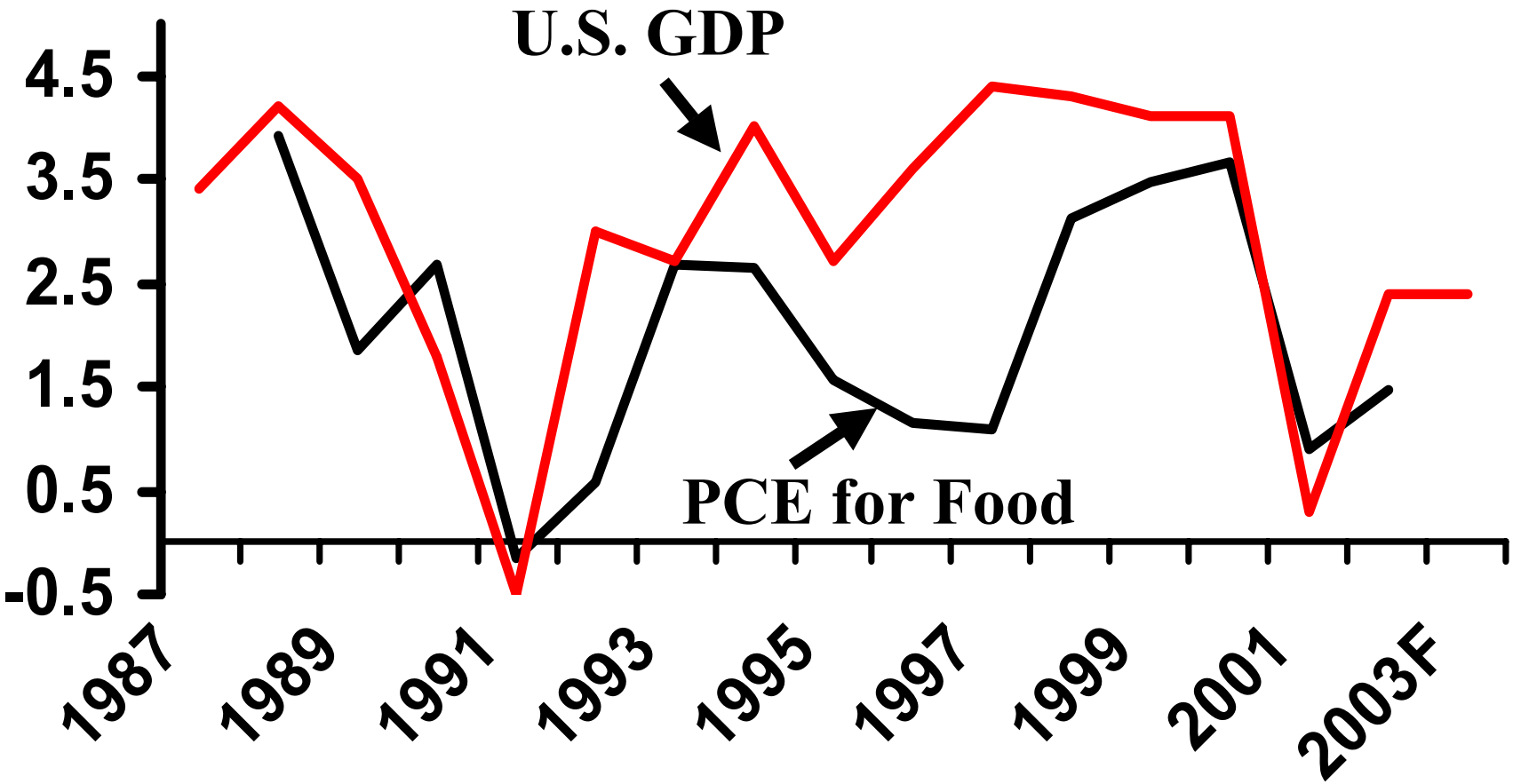
THE OUTLOOK FOR PRODUCTION AGRICULTURE

Keith Collins, USDA

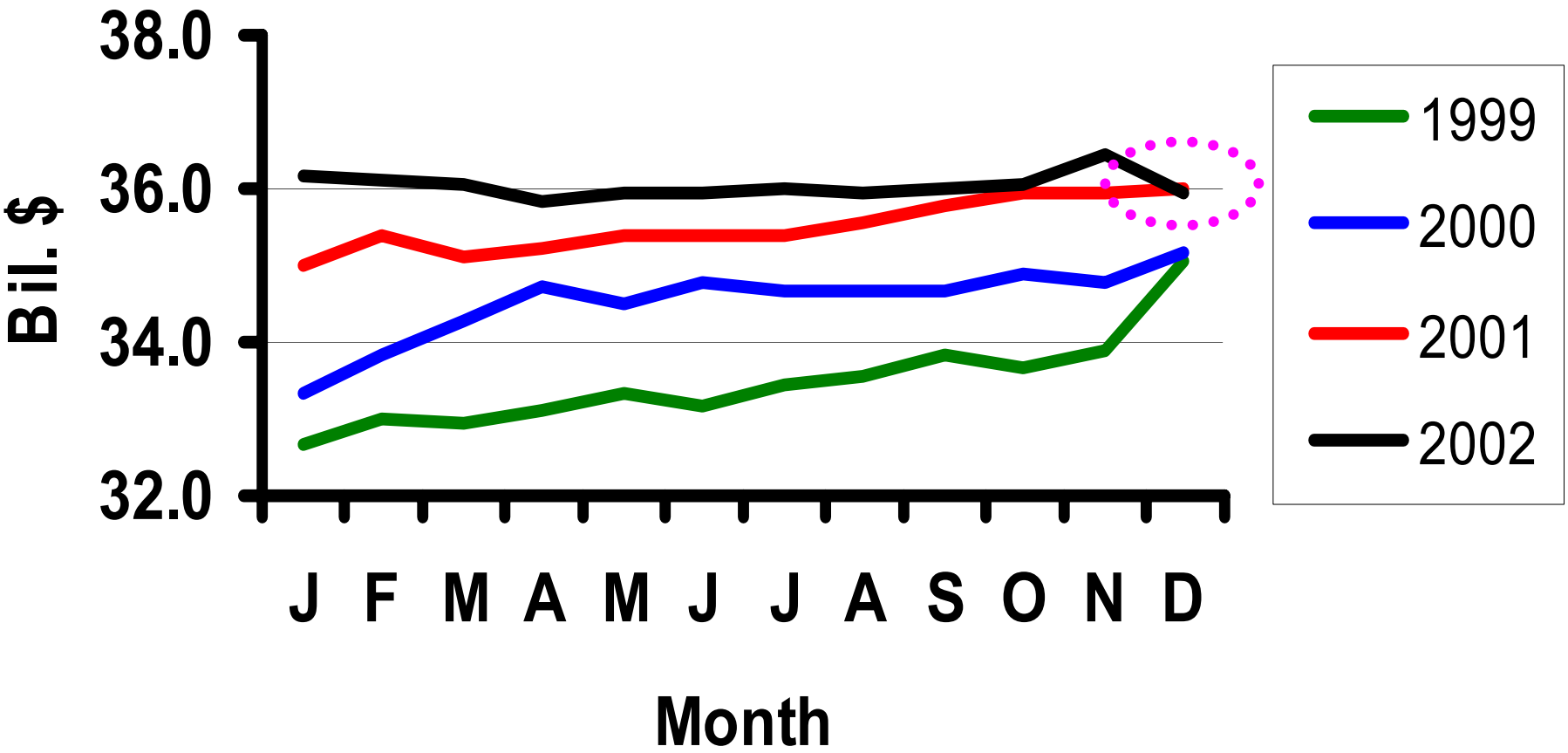
February 20, 2003

1--U.S. REAL GDP AND FOOD SPENDING

Annual percentage changes



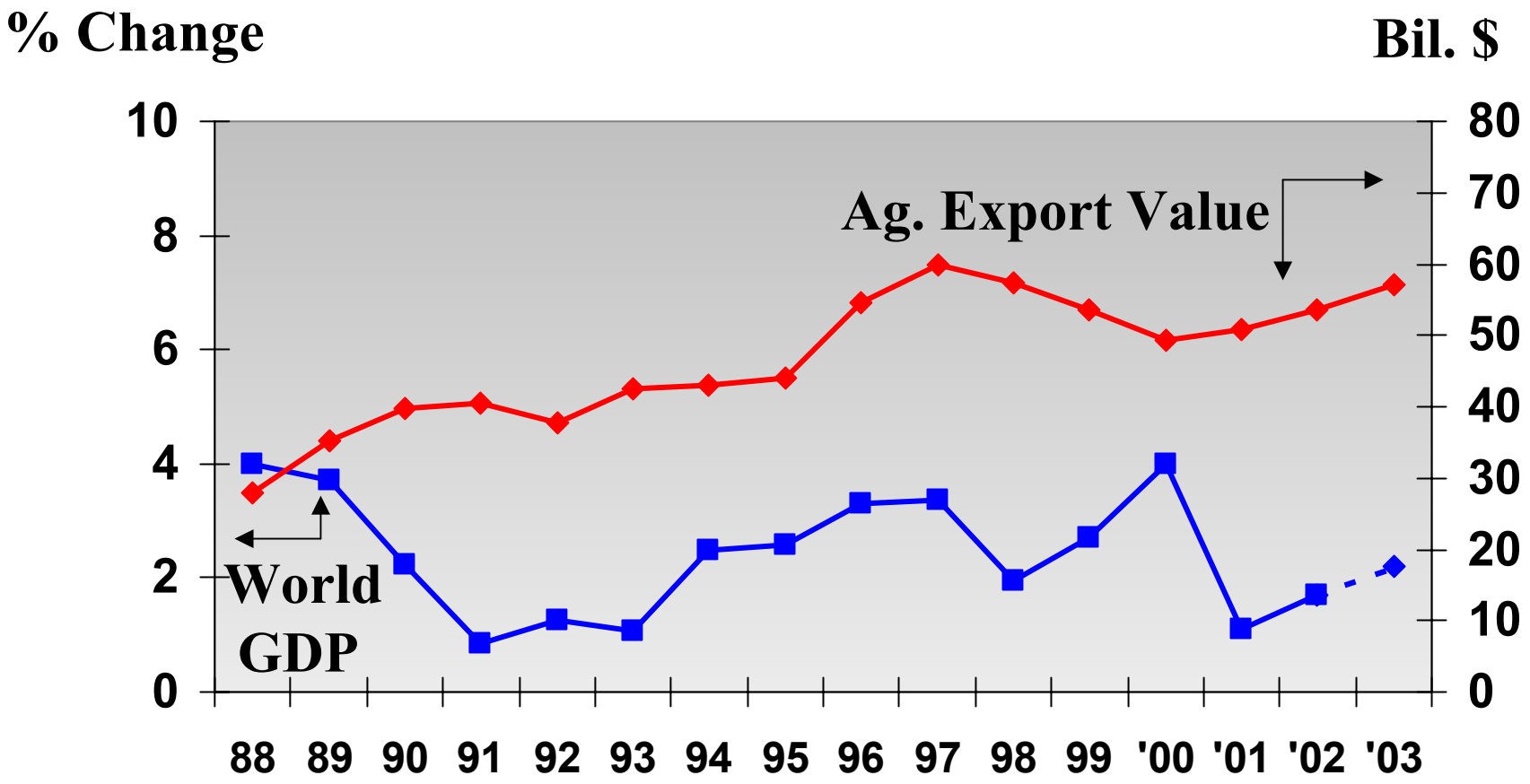
2--GROCERY STORE SALES



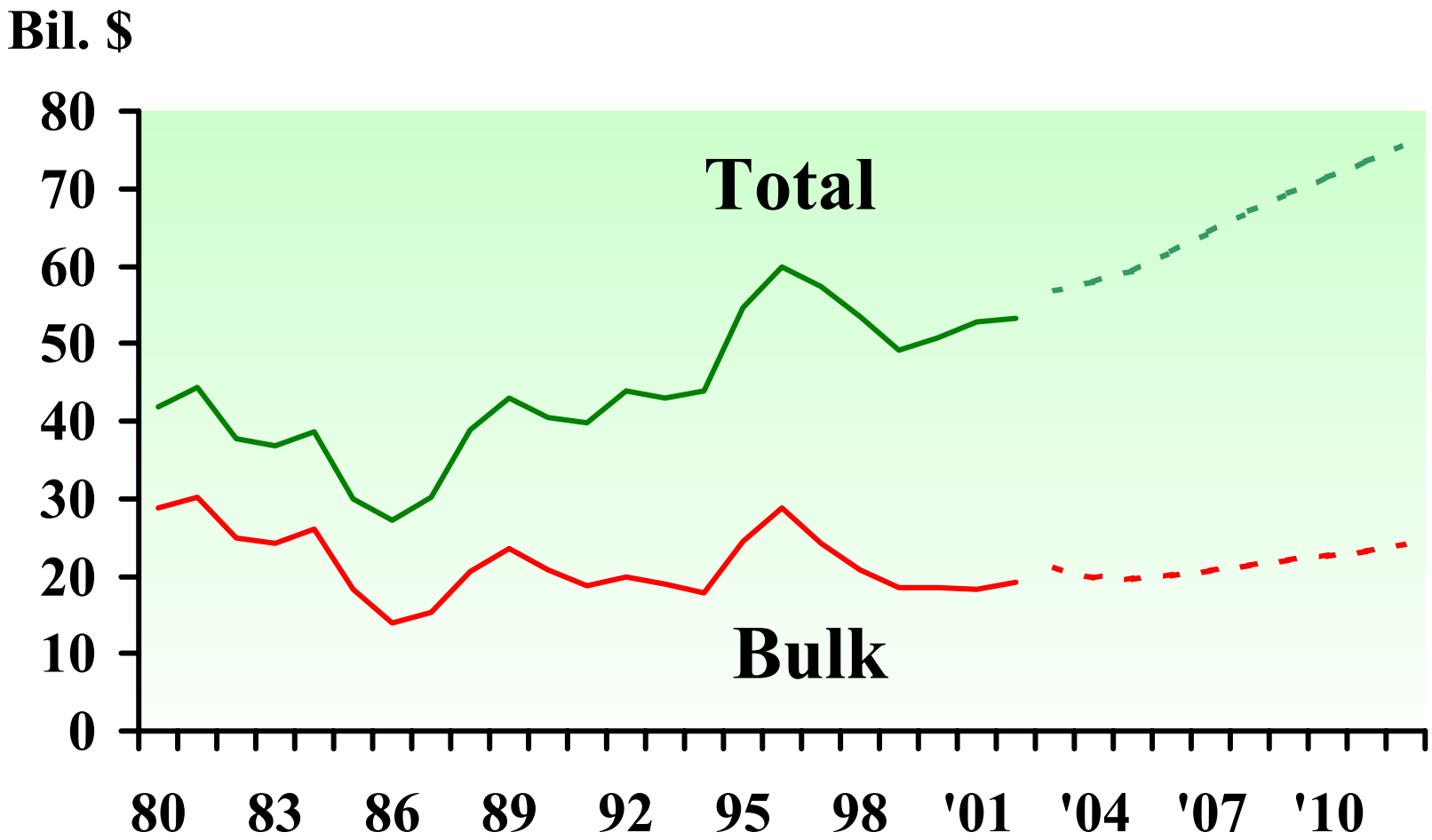
3--LOOKING AHEAD, PER CAPITA CONSUMPTION ON …

- **Fruits** ⇧⇧
- **Vegetables (ex. potatoes)** ⇧⇧
- **Yogurt, eggs** ⇧
- **Grains, nuts, seeds** ⇧
- **Poultry** ⇧
- **Milk, cheese** ⇩
- **Beef, pork** ⇩
- **Potatoes** ⇩

4--WORLD GDP AND U.S. AG EXPORTS

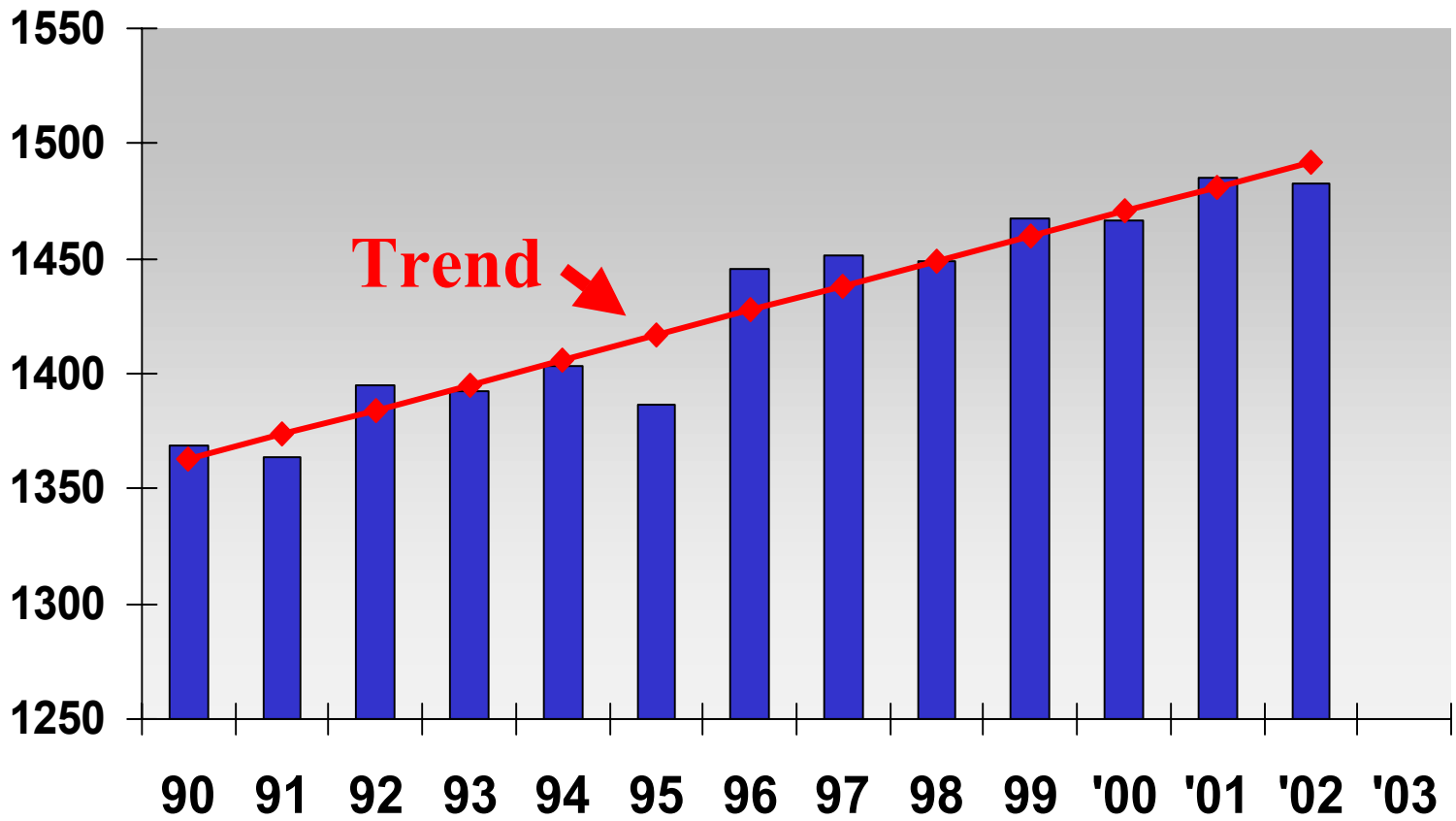


5--U.S. EXPORTS DRIVEN BY HIGH VALUE

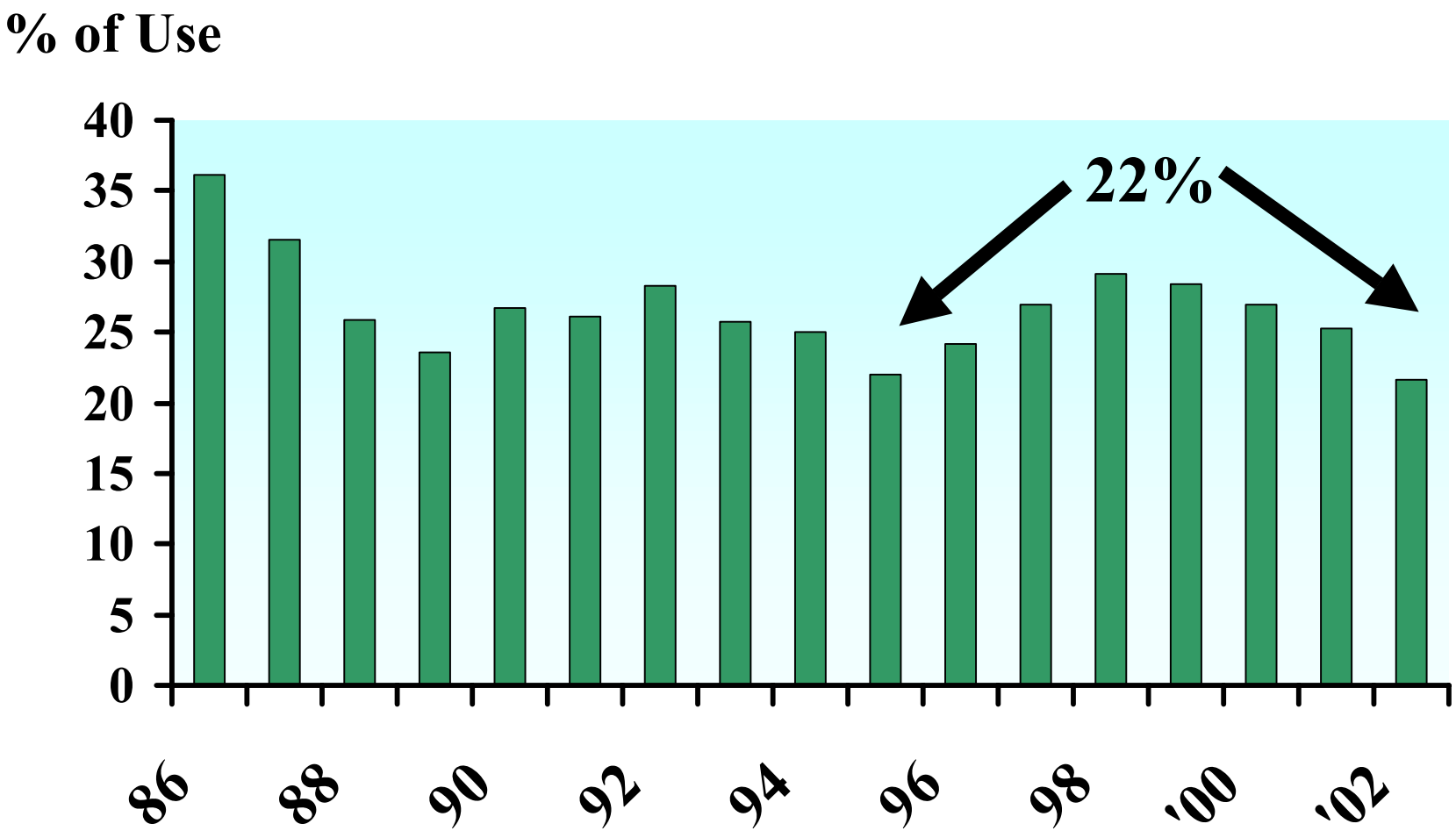


6--WORLD GRAIN USE

Mil. tons



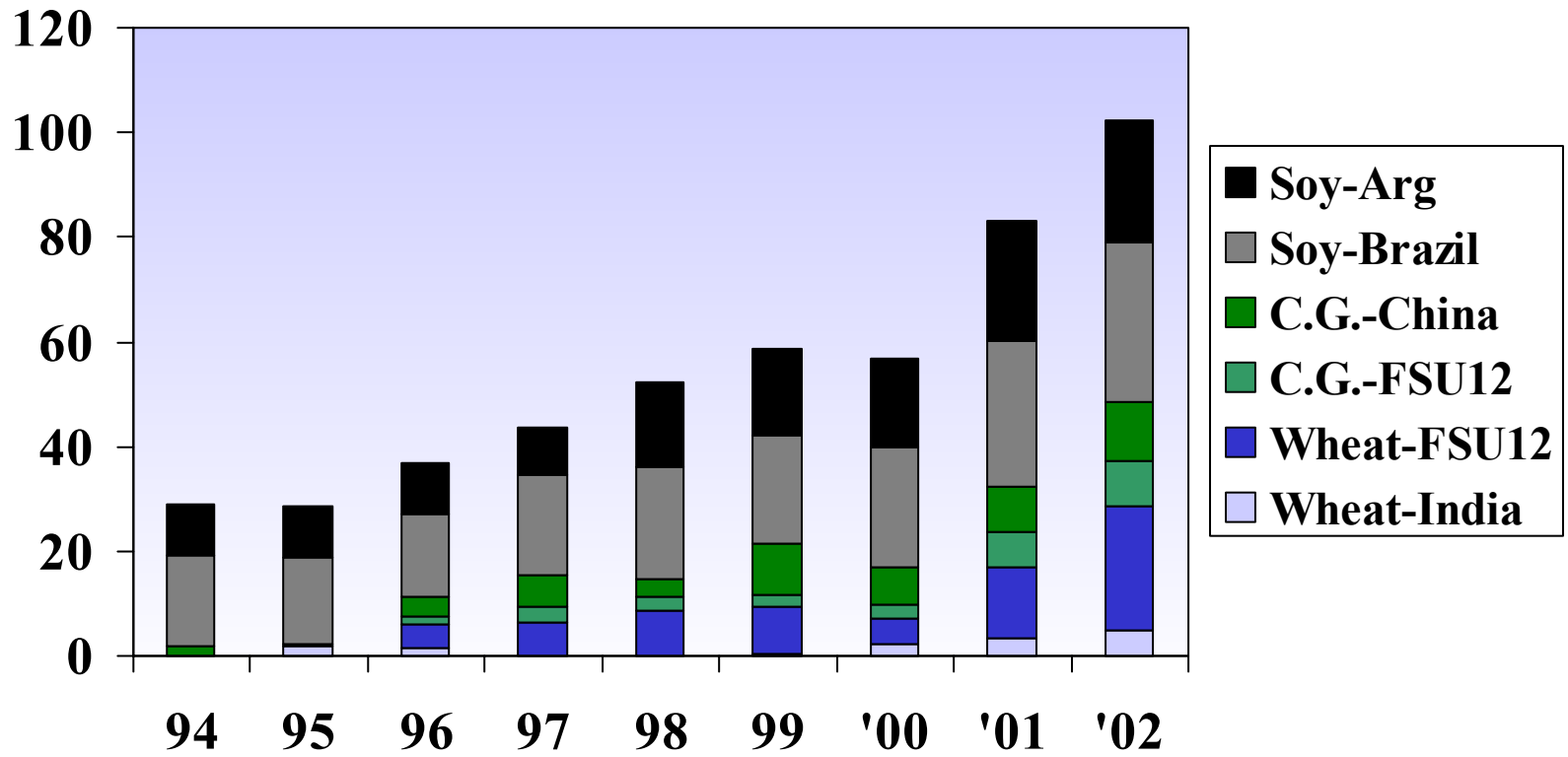
7--WORLD GRAIN STOCKS



8--EMERGING COMPETITORS RISE

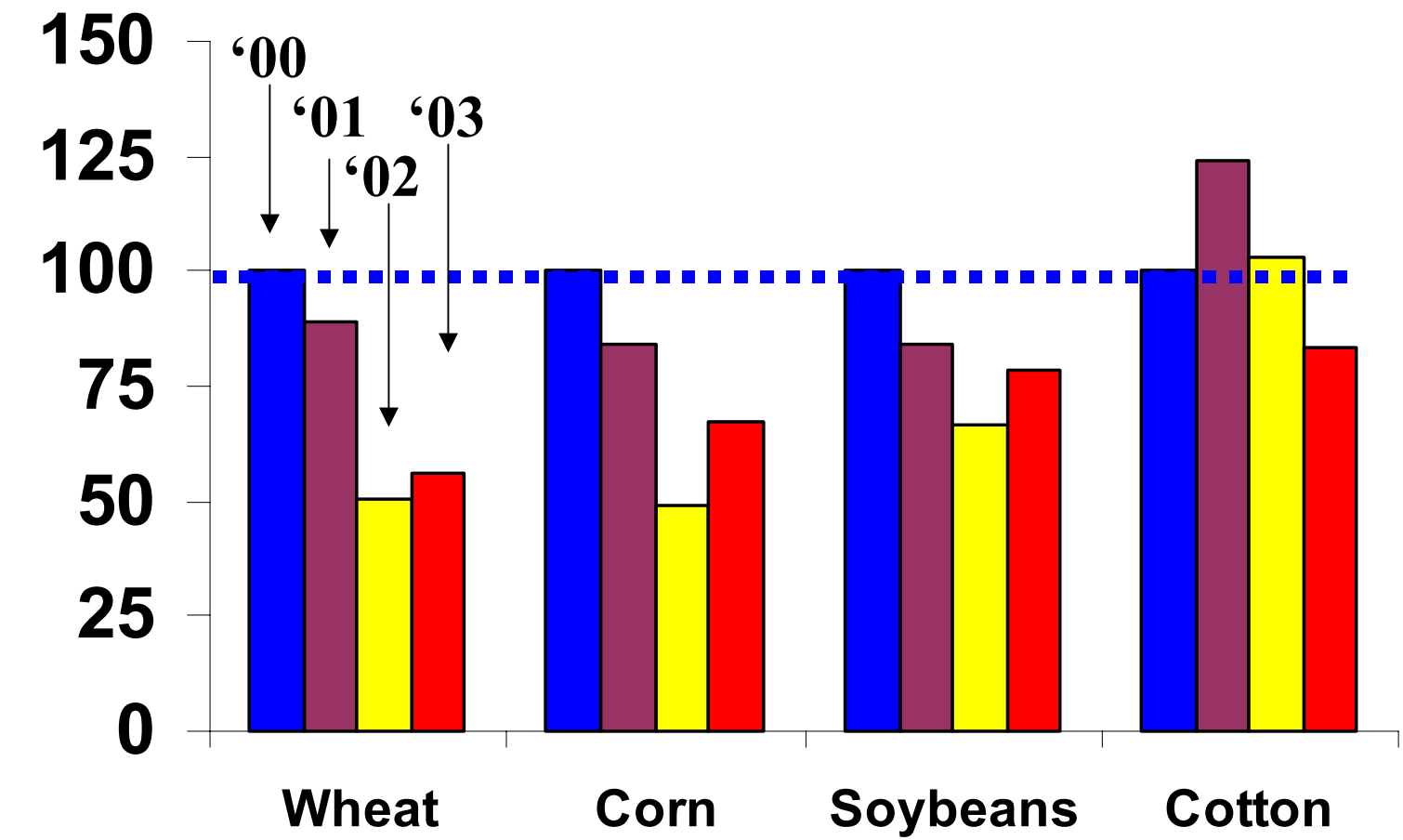
Grain and Soybean Exports

Mil. tons



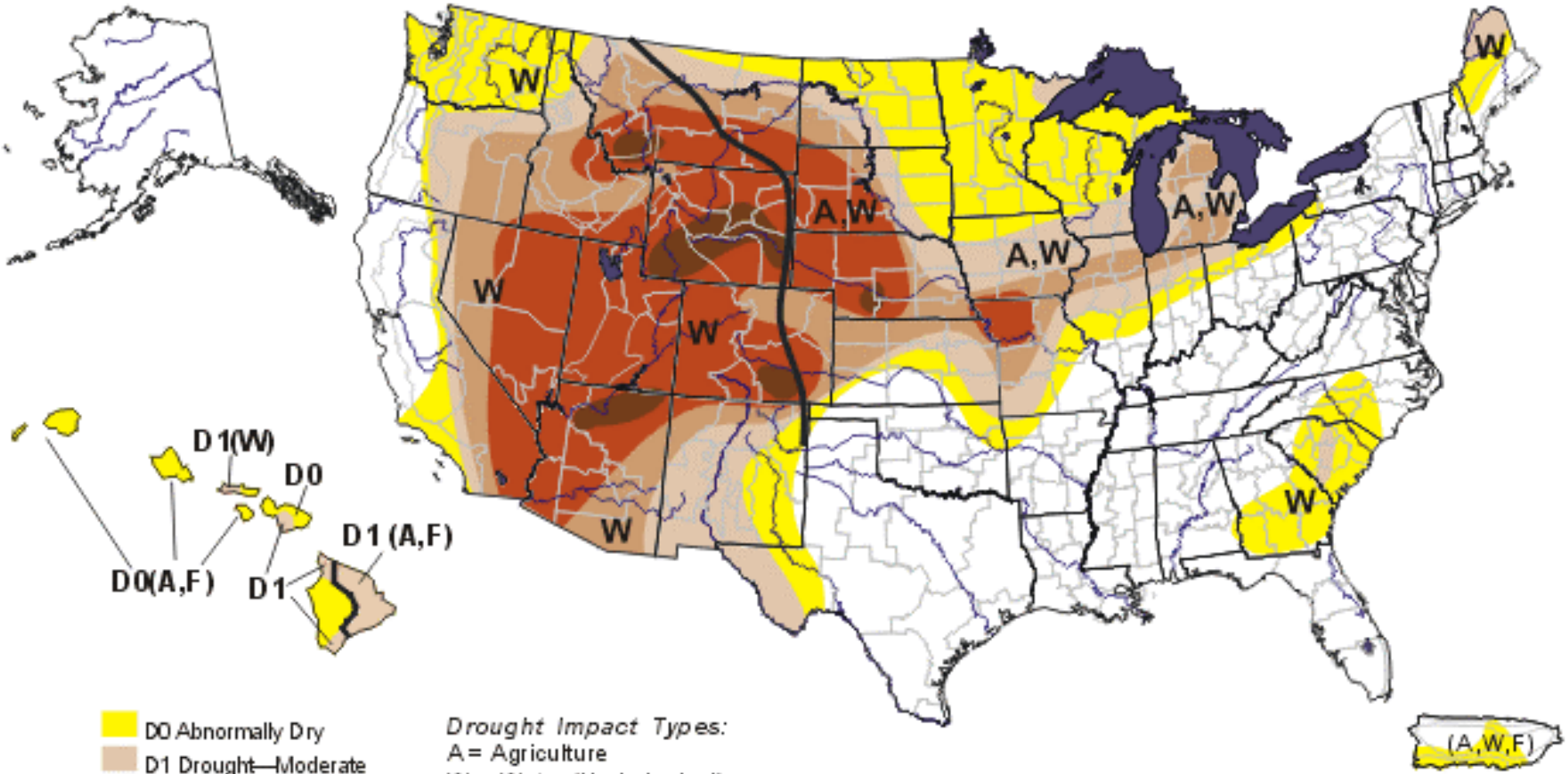
9--U.S. CARRYOVER STOCKS: KEY CROPS

Percent of 2000/01 Level



U.S. Drought Monitor

February 11, 2003
Valid 7 a.m. EST



D0 Abnormally Dry
D1 Drought—Moderate
D2 Drought—Severe
D3 Drought—Extreme
D4 Drought—Exceptional

Drought Impact Types:
A = Agriculture
W = Water (Hydrological)
F = Fire danger (Wildfires)
Delineates dominant impacts
(No type = All 3 impacts)

The Drought Monitor focuses on broad-scale conditions. Local conditions may vary. See accompanying text summary for forecast statements.

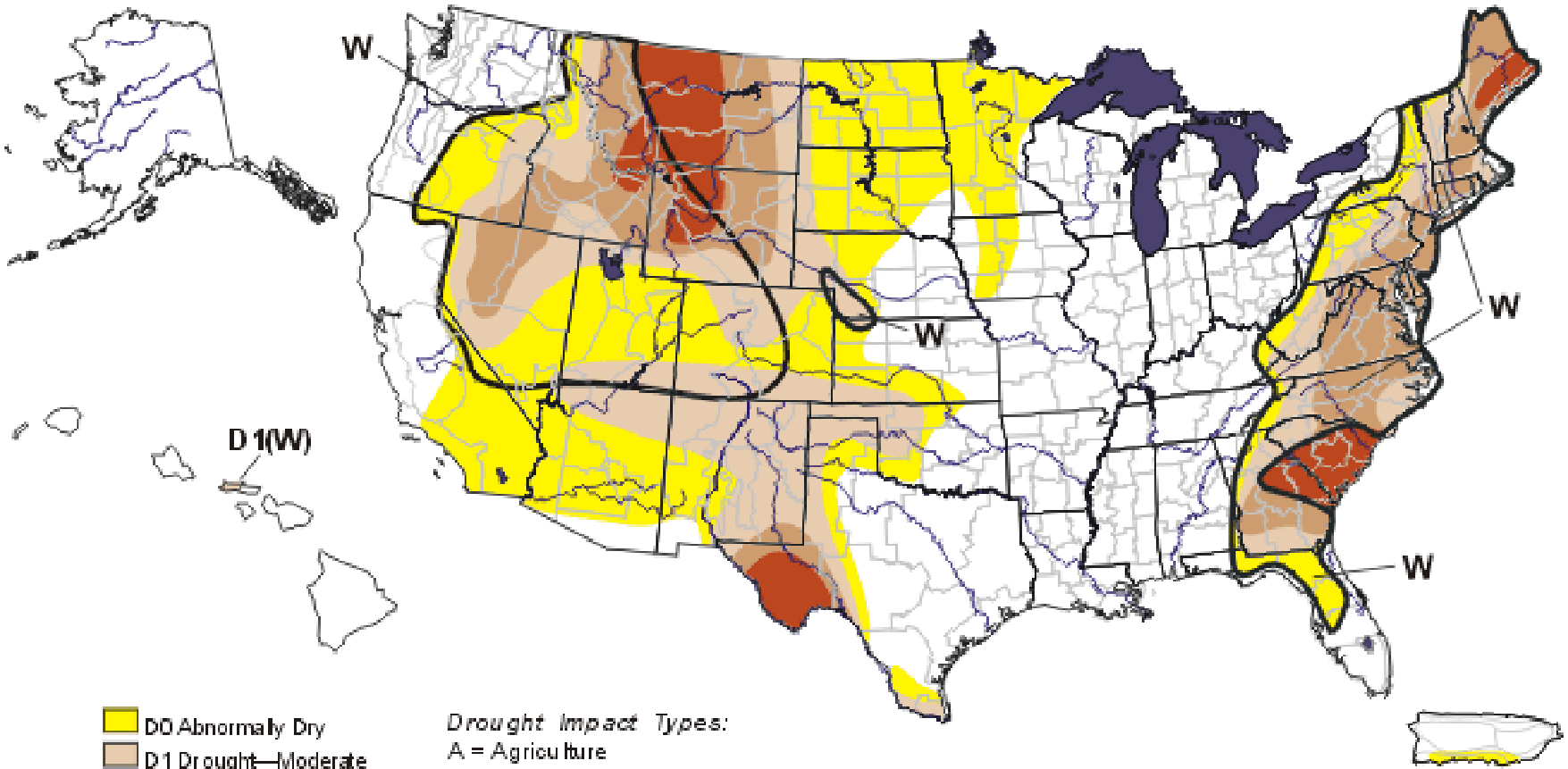
http://drought.unl.edu/dm

Released Thursday, February 13, 2003

Author: *Mark Svoboda, NDMC*

U.S. Drought Monitor

February 12, 2002
Valid 8 a.m. EST



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Drought Impact Types:
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Delineates dominant impacts
(No type = All 3 impacts)

The Drought Monitor focuses on broad-scale conditions. Local conditions may vary. See accompanying text summary for forecast statements.

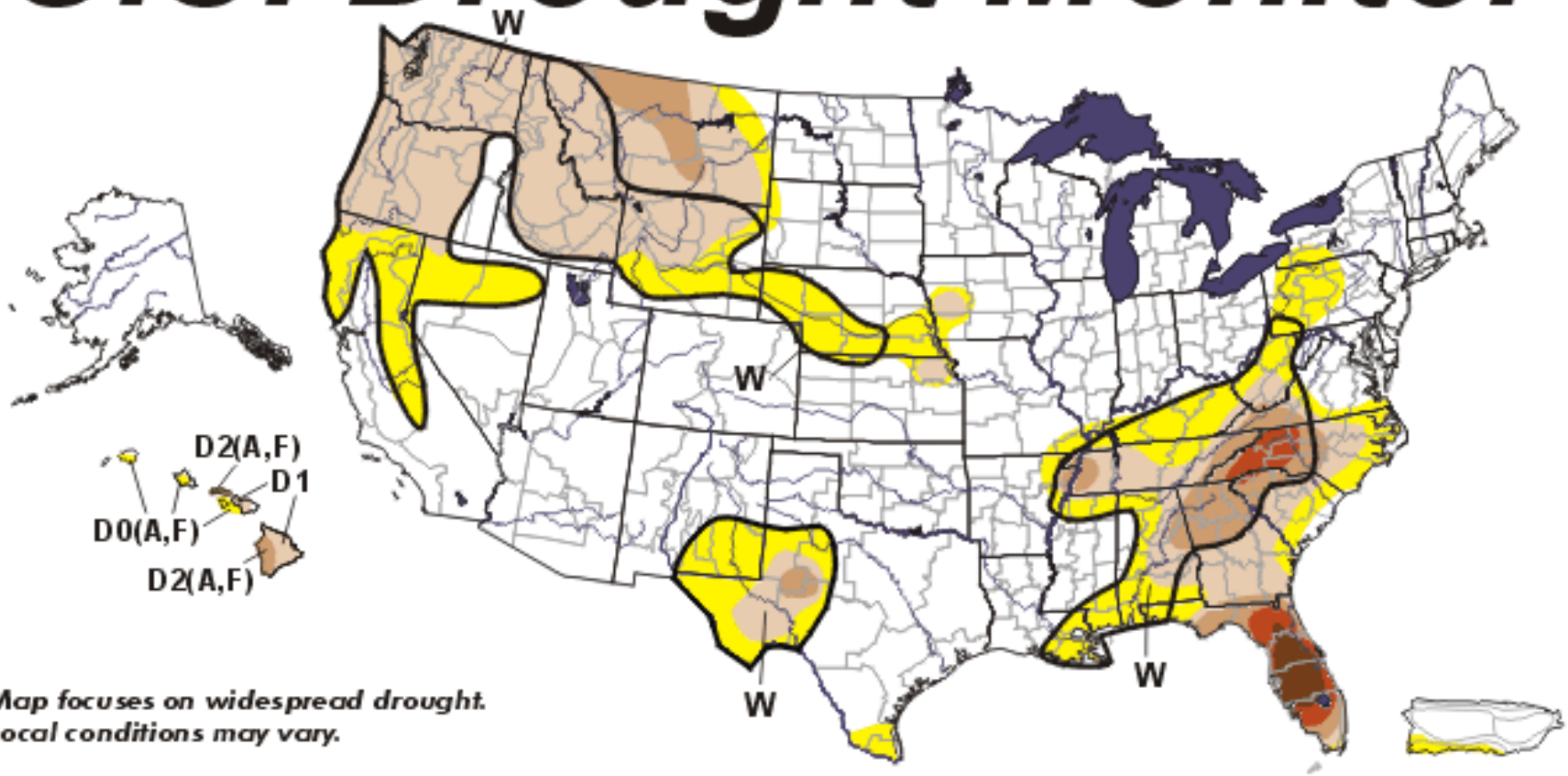
http://drought.unl.edu/monitor/monitor.html

Released Thursday, February 14, 2002

Author: *Mark Svoboda, NDMC*

February 13, 2001 Valid 7 a.m. EST

U.S. Drought Monitor



Map focuses on widespread drought.
Local conditions may vary.

- D0 Abnormally Dry
- D1 Drought–Moderate
- D2 Drought–Severe
- D3 Drought–Extreme
- D4 Drought–Exceptional
- Delineates Overlapping Areas

Drought type: used only when impacts differ

A = Agriculture
W = Water (Hydrological)
F = Fire danger (Wildfires)

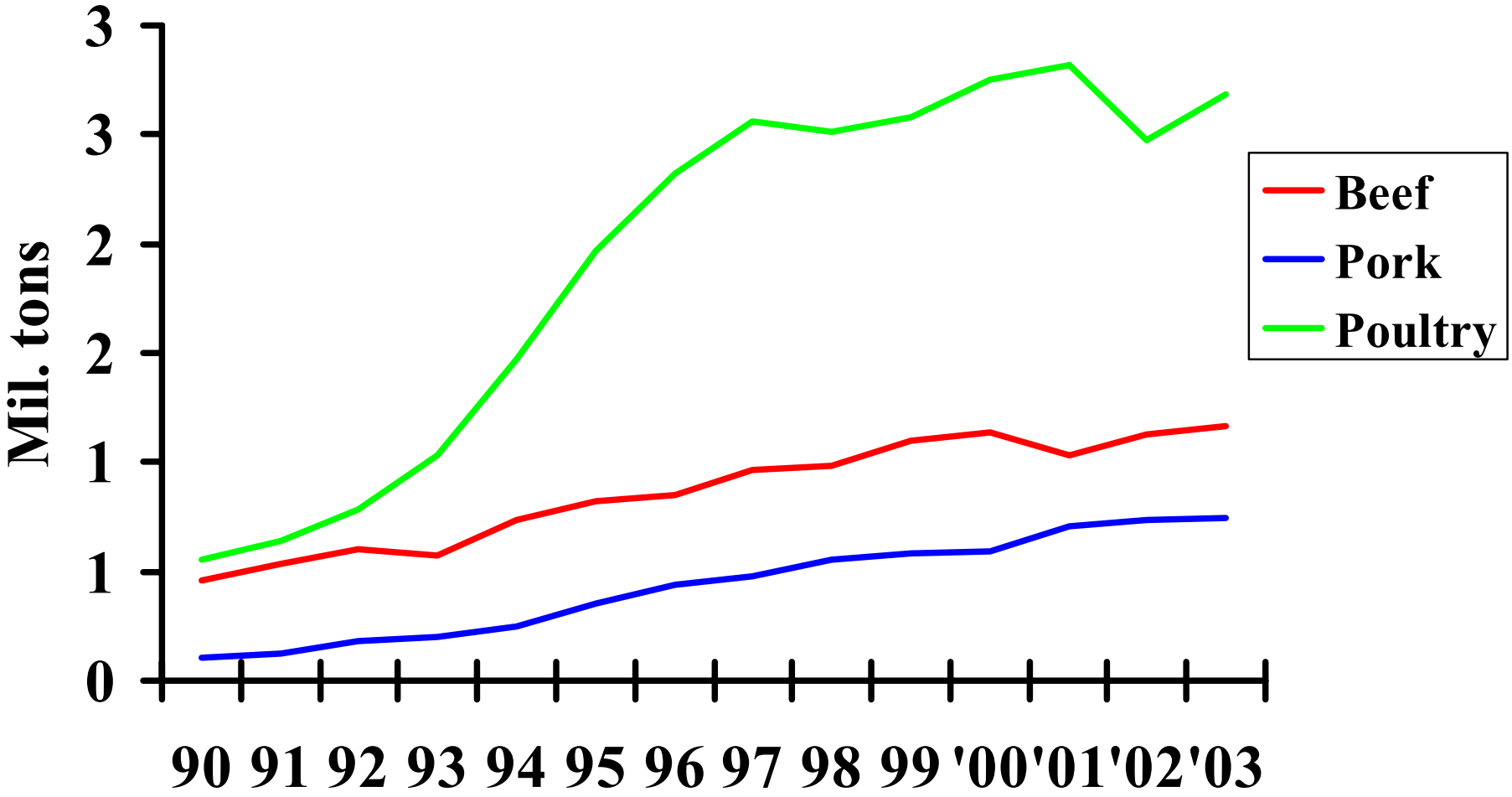
USDA · National Drought Mitigation Center · NOAA

See accompanying text summary for forecast statements
http://enso.unl.edu/monitor/monitor.html

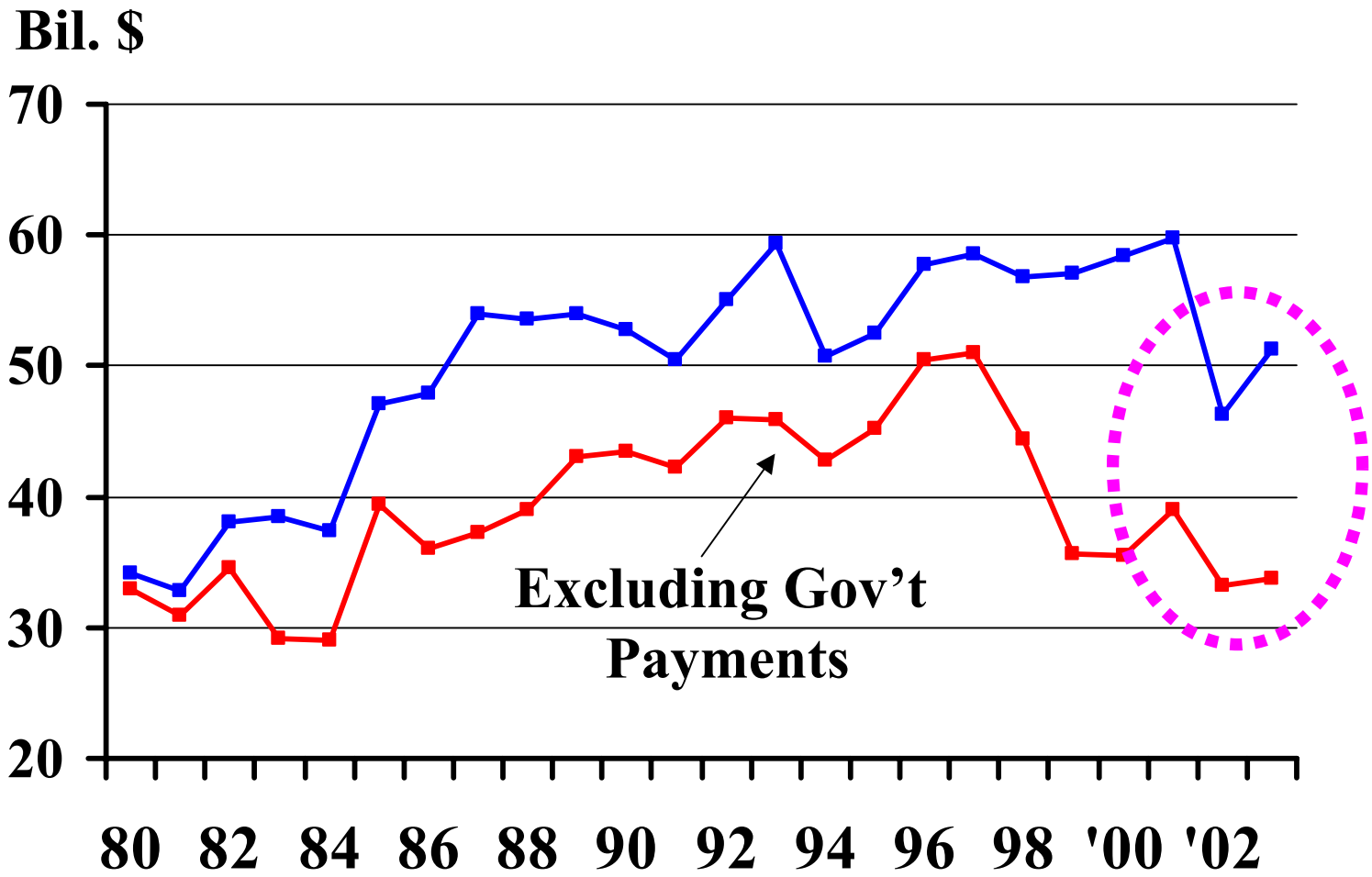
• ***Released Thursday, Feb. 15, 2001*** •

Author: *David Miskus*

13--U.S. MEAT EXPORTS



14--U.S. NET CASH FARM INCOME



15--U.S. FARMLAND VALUES—CORN BELT